IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1942.

No. [redacted] 110

W. E. RICHARDSON, in His Own Right and as Trustee, and Others,

Petitioners,

vs.

BLUE GRASS MINING CO., and Others,

Respondents.

BRIEF FOR RESPONDENTS

In Opposition to the Petition for Writ of Certiorari to the Circuit Court of Appeals for the Sixth Circuit.

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1942.

No. 1274.

W. E. RICHARDSON, in His Own Right and as Trustee, and Others,

Petitioners,

vs.

BLUE GRASS MINING CO., and Others,

Respondents.

BRIEF FOR RESPONDENTS

In Opposition to the Petition for Writ of Certiorari to the Circuit Court of Appeals for the Sixth Circuit.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The respondents, Blue Grass Mining Company and others, in opposition to the petition herein for a writ of certiorari to the Circuit Court of Appeals for the Sixth Circuit, respectfully represent:

I.

The opening statements of the petition herein do not correctly describe the nature, purport or purpose of the action. Its character is to be determined from the bill of complaint (Record, Vol. 1, pp. 1-53). It sets up the written contract of December 7, 1929, the various articles of incorporation of the five companies, and the written contract of February 18, 1931. It did not allege any breach of either contract, or that any subscription for the stock of the corporations had been paid for by plaintiffs.

It assumed that the mere signing by dummies of the articles of incorporation of Blue Grass Mining Co. and Pendleton Stores, Inc., constituted the complainants stockholders and expressly sought (1) a reformation of the contract of February 18, 1931, so as to give them a 50 per cent interest instead of a 30 per cent interest provided by the contract, and (2) an accounting by the officers of the corporations for salaries and expenses paid to them from year to year from 1930 to 1936, and for certain other items.

The bill of complaint was amended eight times:

1. First amended bill, Vol. 1, p. 137.
2. Amended and supplemental bill, Vol. 1, p. 144.
3. Further and better statement, Vol. 1, p. 152.
4. Amendment to conform to proof, Vol. 1, p. 182.
5. Further amendment and supplemental bill, Vol. 1, p. 255.
6. Bill of particulars, Vol. 1, p. 282.
7. Amended and supplemental bill, Vol. 1, p. 326.
8. Second amendment to bill of particulars, Vol. 1, p. 332.

The essential character of the action was never changed except the reformation of the contract of February 18, 1931, sought in the original bill, was changed on August 2, 1937 (more than five years after the contract was made),

to a prayer for a rescission of that contract (Record, Vol. 1, p. 182).

At no time nor by any pleading did the complainants seek to establish the quantum of interest in the contracts other than the claim in the bill that they "were entitled to one-half of the stock in the two corporations" (Record, Vol. 1, p. 3). They did not allege that they ever paid any money on the subscriptions and, in truth, never did so. A full and complete statement of the facts is necessary in view of the distorted, inexact and inaccurate "Statement of the Case" by petitioners.

II.

STATEMENT OF THE CASE.

J. E. Johnson, Sr., was the owner of a bid for certain coal properties at Hazard, Kentucky, sold at a receiver's sale under a decree of the Perry Circuit Court. He had paid $2,800.00 of the purchase price, and had executed sale bonds for the balance of $11,200.00. In addition, he had expended about $8,000.00, and had arranged to pay certain lien claims on a royalty basis of 10 cents per ton of coal mined from the No. 7 seam. Mr. Johnson had matured plans for operation of the property under the bid, and for the formation of two or three corporations to operate the mines, to conduct the commissary, and to hold the title of the real estate. William Pendleton had been started to work, and was engaged in preparation. In this situation, M. T. MrArthur and Ferdinand Powell of Johnson City, Tennessee, began negotiations for the purchase of an interest in the bid which Mr. Johnson held. The negotiation resulted in a written contract dated December 7, 1929, which was the origin and the measure of the rights acquired and the obligations assumed. The subject matter of the contract was the bid. The contract is Exhibit A with the bill of complaint (Record, Vol. 1, pp. 53-55).

It will be observed that the contract protected the plaintiffs against any liability whatever except in so far as they expressly consented. It was signed by M. T. McArthur, trustee, who represented, as later appeared, himself, Mrs. Ferdinand Powell, W. E. Richardson and R. W. Lawson.

The contract gave McArthur, trustee,

> (1) A one-half interest in the bid and the property acquired or to be acquired thereunder. But until title to such property was vested in the parties in equal moieties no obligation was imposed; and
>
> (2) One-half of the stock in the one, two or three corporations that might be organized to own and operate the mines, or to do either. These rights were dependent and conditional on the confirmation of the sale to Mr. Johnson, it being known that an appeal to the Court of Appeals was then contemplated (Record, Vol. 2, pp. 329-335).

The contract obligated M. T. McArthur, trustee, as follows:

> (1) To pay $1,400 in cash, which was to be returned to McArthur by the Receiver in the event the sale was not confirmed by the Court of Appeals.
>
> (2) To pay Mr. Johnson $4,000 when and after the sale was confirmed, and "title vested in the parties to the contract, or their assignees, in equal moieties";
>
> (3) To bear one-half of the costs incurred thereafter, but only by agreement as to such expense; and any compromise or settlements were to be made by both parties agreeing thereto and each paying one-half thereof;
>
> (4) To accept the royalty agreement theretofore made as a means of paying labor and compensation claims from coal mined from No. 7 seam, which arrangement was ratified and adopted;
>
> (5) To pay one-half of the sale bonds of $11,200 on which Johnson was obligated. Each party was to pay

$5,600 thereof, if it became payable as a result of confirmation of the sale by the court of last resort;

(6) To take one-half of the stock in one, two or three corporations to be organized, to own and operate the mines and store, but only "in the event the sale was confirmed."

Pursuant to this contract, two corporations were organized. One was The Blue Grass Mining Company, with an authorized capital stock of $10,000, to operate the mines, and the other was the Pendleton Stores, Inc., with an authorized capital stock of $5,000, to conduct the commissary. The title to the bid was held by F. J. Eversole, but was controlled by the parties to the contract, and the organization of a corporation for that purpose was deferred until the title was confirmed. The articles of incorporation of both companies were signed by selected persons representing the contracting parties. Neither J. E. Johnson, Sr., nor M. T. McArthur, trustee, signed the articles of incorporation of either company, but this was not material, as the corporations were organized pursuant to the contract and subject to the control of Johnson and McArthur. The corporations were mere instrumentalities under the contract. No stock was issued or paid for until after the first contract was ended by the Court of Appeals when it reversed the judgment of confirmation. Mr. Johnson and his associates then paid up the stock in both companies. The reversal of the judgment destroyed the subject matter of the contract, which was the bid. McArthur and associates put up $2,500 in the form of check signed by Mrs. Ferdinand Powell. This was entered on the books as a debt due Mrs. Powell from the corporation, and was so carried throughout the period of this litigation, with certain credits thereon by reason of payments made back to the Powells. In fact, more than half of the amount was returned to them. Johnson put up $1,500, which was en-

tered on the books in the favor of J. E. Johnson, Jr., who had actually expended the money for the company (Record, Vol. 4, p. 953), and the bookkeeper entered it to his credit (Record, Vol. 3, p. 664). It was the money of J. E. Johnson, Sr., and was later changed on the books to his credit (Record, Vol. 2, p. 305). In addition, Johnson had spent $8,000, as shown by both contracts and as alleged in the bill itself (Vol. 1, p. 6). The parties began at once to put the coal mines in shape, and actually shipped coal on January 1, 1930 (Record, Powell Exhibit No. 4, Vol. 2, p. 83). Arrangements were made with the Midland Coal Sales Company to advance money on coal shipped, and in that way the operations were carried on until May 30, 1930, on which dates the Court of Appeals reversed the judgment of the Perry Circuit Court and set aside the sale (Wakenva Coal Co. v. Johnson, 234 Ky. 558, 28 S. W. [2d] 737).

The effect of this judgment was to extinguish the bid which was the subject matter of the first contract. In legal effect it terminated the contractual relations existing between the parties, and relieved M. T. McArthur, trustee, of all obligations under the contract, and of all obligations incidental thereto. Any earnings or assets of the corporations acquired during the period of operation would have to be accounted for to the true owners of the property, and hence there was no occasion or motive for McArthur, trustee, to remain in the matter, unless a new contract for the purchase of the land could be negotiated.

The Blue Grass Mining Company negotiated a contract with the Receiver to operate the mines pending a resale of the property. When the Court ordered a resale of the property it was ordered in two parts. The first portion was sold on October 27, 1930, and was purchased by J. E. Johnson, Jr., who gave the bond required by law. On December 22, 1930, the remainder of the property was

sold and bid in by S. P. Camack, whose bid was duly assigned to J. E. Johnson, Jr. Immediately thereafter, on December 27, 1930, Ferdinand Powell opened negotiations for an interest in the new purchase (Record, Powell Exhibit No. 20, Vol. 2, page 130). Negotiations continued, but no contract resulted. On February 7, 1931 (Record, Powell Exhibit No. 81, Vol. 2, page 264), Powell expressed a willingness to accept a new contract on the basis of 35 per cent to McArthur and his associates, 35 per cent to Johnson and his associates, and for Johnson to place "30 per cent as he saw fit," with a further agreement for reimbursement to both parties of amounts theretofore paid, and for the Tennessee group to be relieved of paying the $4,000 referred to in the contract of December 7, 1927. He also desired an option at $5,000.00 on 5 per cent of the stock in the new company to be organized. Powell stated in that letter that so far no headway had been made towards a new contract, and he hoped that they would be able to reach an agreement so that, in case of failure to do so, each party might know where he stood. The letter resulted in a meeting on February 18, 1931, when a new contract was completed after long discussion, and after the rejection of a proposed contract written by Powell. This contract is Exhibit F with the bill of complaint (Record, Vol. 1, pages 69-71). This contract defined the rights of the parties in all respects, superseding all prior negotiations, rights or understandings, express or implied. It differed in some material respects from the previous contract of December 7, 1929, and did not provide for the bids or any interest therein to be assigned or transferred to Mr. Richardson, trustee, who signed the agreement, but expressly provided for both bids to be assigned, transferred and vested by J. E. Johnson, Jr., in a new corporation to be organized by the parties in which the stock was to be held on the basis of 30 per cent to Richardson and associates and 70 per cent to Johnson and

associates. This was the form or plan stipulated by the parties, and after it was executed it was necessary for all parties to follow it in order to obtain the rights it gave. It constituted a settlement of any dispute or claim, and a compromise of any controversy growing out of prior transactions, duties or obligations.

The contract was complete and comprehensive. It provided that Richardson, trustee, should have the rights specified, to wit:

(1) 30 per cent of the stock of a corporation to be organized by the parties;

(2) 30 per cent of the stock of Blue Grass Mining Company;

(3) 30 per cent of the stock of Pendleton Store, Inc.;

(4) Relief from payment of $4,000.00 required by the contract of December 7, 1929 (in fact, the reversal of the judgment by the Court of Appeals had already extinguished that obligation);

(5) Payment by the corporation to be created of $3,900.00 to Richardson;

(6) 30 per cent of a one-third stock interest in Jeda Coal Co.;

(7) 30 per cent of a third stock interest in Black Gold Mining Co. (but the one-third interests in Jeda Coal and Black Gold were to become assets of the corporation to be created);

(8) If a sales company should be formed, Richardson, trustee, could subscribe for and take 50 per cent of the capital stock of such sales company.

Johnson and his associates were to have 70 per cent of everything in which Richardson, trustee, was to have 30 per cent, and 50 per cent of the sales company stock, if one were organized. Johnson was to be paid $7,500.00 by the corporation to be organized by the parties.

Thus, the corporation to be organized was to take over the properties bid in and held by J. E. Johnson, Jr., and was to pay the purchase price. It was to take 30 per cent of one-third of the stock in both Jeda and Black Gold, and pay for it. It was to pay Johnson $7,500.00, and Richardson, trustee, $3,900.00.

A policy of life insurance in the amount of $25,000.00 on the life of J. E. Johnson, Sr., was to go to the proposed new company, and, necessarily, it would have to pay the cost of carrying the insurance from the beginning. The obligations thus to be assumed by the corporation to be formed by the parties appeared to be as follows:

(a) To pay the purchase price.....	$52,600.00
(b) To pay W. E. Richardson, trustee.....	3,900.00
(c) To pay J. E. Johnson, Sr.	7,500.00
(d) To pay Jeda Coal Co. (⅓ of $25,000)...	8,333.50
(e) To pay Black Gold (⅓ of $5,000).....	1,667.67
	$74,000.00

The cost of carrying the insurance would add at least $5,000.00. The contemplated corporation must have had at least $80,000.00 to discharge the obligations contemplated by the contract. Some operating capital would be required and the estimate of $100,000.00 mentioned from time to time was about the minimum requirement of the plan. Powell's letter of February 7, 1931 (Record, Exhibit No. 81, Vol. 2, p. 264), requested an option on 5 per cent of the stock at $5,000.00, which corroborates and confirms the estimate that an authorized capital of $100,000.00 was contemplated.

On May 25, 1931, the trustee, W. E. Richardson, filed a written declaration of trust (Record Vol. 2, pp. 38 and 39). It recited the holding of a 30 per cent interest under the contract of February 18, 1931, and declared that it was held for Miss T. R. Porter, one-half; Miss Margaret H.

Powell, three-tenths of the 40 per cent, and to W. E. Richardson and R. W. Lawson, one-fifth of the 30 per cent. It further declared that as soon as stock is issued in the companies now organized, or to be organized in pursuance to the contract, it would be turned over to the parties as set out.

This declaration defined the subject matter of the trust assumed by Richardson. He was trustee of nothing except the rights conferred by the contract of February 18, 1931. Operations continued under the contract of February 18, 1931, without question by anybody until February 8, 1936. There was a long delay caused by litigation in various forms, and other circumstances beyond the control of the parties. An appeal had been taken to the Court of Appeals from the orders confirming the second sales of the properties. By mutual assent nothing was done towards carrying out the contract until disposition of all controversies respecting the title of the property (Record Vol. 3, p. 484). In fact, it was impossible to go forward with the steps outlined by the contract until the title to the property was established. The contract was predicated on that proposition, and Mr. McArthur testified rather boastfully that he had protected his associates against any contribution to the enterprise until the title was assured (Record Vol. 2, p. 318; Vol. 4, pp. 1118-1119). Contrary to the present claim of petitioners, no request or demand was ever made by Richardson, trustee, for the issuance of stock. None was due to be issued until it was fully paid for in money (Ky. Cons. § 193, Ky. Stats. § 568). The second appeal to the Court of Appeals was settled on May 14, 1934 (Record Vol. 2, p. 399), but the other litigation could not be settled and had to be fought out in court. The attorneys for the creditors were claiming a large sum of money from Blue Grass Mining Company for operations on the property prior to the time the legal title was

acquired. The Blue Grass Mining Company was claiming an offset allowance for permanent improvements made during the time of operations. This litigation was not finally settled until after the present litigation was in progress, but in January, 1936, Mr. Johnson believed that the end of the controversy was in sight so that they could go forward under the contract of February 18, 1931. He called a meeting at Lexington to be held on February 8, 1936, and provided expense money for the plaintiffs to make the trip. They did not hold the meeting. Richardson and his associates had already employed and conferred with counsel and had determined to bring suit. The bill of complaint was at least partly prepared. Mr. Powell had prepared a written statement to read to the meeting, and unless the demand of the plaintiffs was accepted no meeting would be held. The gist of the demand was that the contract of February 18, 1931, be changed so as to give plaintiffs a 50 per cent interest instead of 30 per cent, as specified in the contract. No other part of the contract was questioned. All parties agree that up to this time no objections had been made as to the contract of February 18, 1931, or as to the rights or relations of the parties. The plaintiffs had never intimated that the contract of February 18, 1931, was not satisfactory, or that they would ask for anything else. Operations had been carried on under the contract for fully five years. Johnson and his associates had always recognized the contract of February 18, 1931, as defining the respective rights, liabilities and duties of the parties, and had operated on that basis. The refusal of the plaintiffs to go into the meeting on the existing contract, and the demand that it be radically reformed at that late day, constituted a repudiation and renunciation of the contract, and deprived the plaintiffs of all rights under it. It was a deliberate breach of the contract by the plaintiffs themselves.

Immediately thereafter, on February 17, 1936, this suit was filed in pursuance of the plan of action therefore formulated. This action was obviously taken on the advice of counsel. The bill of complaint (Record Vol. 1, pp. 1-53) did not assert any right of action under the contract of February 18, 1931, but sought to reform it so as to provide for 50 per cent to Richardson, trustee, instead of 30 per cent interest, in the two corporations which had been organized under and pursuant to the first contract. It did not allege any breach of the contract, or any performance of it on their part, or either ability, willingness or readiness to perform it. It sought only to reform the written contract so as to make the plaintiff's interest 50 per cent in the said corporations instead of 30 per cent, as the contract and declaration of trust provided. The pleadings were amended from time to time, and finally an amended petition was filed asking for a rescission of the contract on the ground of misrepresentation respecting the association of Mr. English in the enterprise (Record Vol. 1, pp. 144-151). This was more than five years after the contract was made and was too late.

Under well-settled principles of Kentucky law, an action for relief from fraud must be brought within five years from the time the cause of action accrued. Ky. Stats., § 2519. A petition that does not allege that the fraud was not discovered within the period of five years, and could not have been discovered within that time, is not good.

> Wood v. James, 87 Ky. 511;
> Brown v. Brown, 91 Ky. 639;
> Cox v. Simmerman, 243 Ky. 474, 48 S. W. (2d) 1078.

In this case there was no fraud in fact, but the circumstances respecting English upon which plaintiff relied and upon which the Court set aside the contract of February 18, 1931, were known by plaintiffs at all times.

Moreover, the petitioners had elected to abide by the contract and had raised no question about it for more than five years. It is well settled by the decisions of this Court, and of the Court of Appeals of Kentucky, that "when fraud in the making of a contract is discovered, the party defrauded has an election to rescind the contract or to stand upon it and sue for damages caused by the deceit. He must, in order to rescind, promptly so elect and notify the opposite party and adhere to the position taken." The election is irrevocable.

Grymes v. Sanders, 93 U. S. 55, 23 L. Ed. 798;
McLean v. Clapp, 141 U. S. 429, 35 L. Ed. 804;
Hoyt v. Latham, 143 U. S. 553, 35 L. Ed. 259;
Shappiro v. Goldberg, 192 U. S. 553, 48 L. Ed. 419;
Farmers Trust Co. v. Threlkeld's Admr., 257 Ky. 211, 77 S. W. (2d) 616;
Dolle v. Melrose Properties, 252 Ky. 482, 67 S. W. (2d) 706;
MacKenzie v. Eschmann's Exrs., 174 Ky. 450, 192 S. W. 521.

Moreover, the contract of February 18, 1931, was the only contract the complainants had. The first contract was upon a different subject matter—the bid at the first sale—and was ended by its own terms by the reversal of the judgment.

After the contract of February 18, 1931, was set aside they had no contract at all. Yet the Court gave them one-half of the stock in the Blue Grass Mining Company and one-half of the stock in the Pendleton Store, Inc., without requiring it to be paid for by complainants. The Court then proceeded to place in the Blue Grass Mining Company title to all the property that had been acquired and the entire capital stock of the Blue Grass Coal Co. (Sales Co.). This was in utter disregard of the plan of the parties from the beginning to keep the real estate and other property separate from the operating company.

The claim to the stock in Black Gold Mining Company and Jeda Coal Company was baseless. Those companies were organized on December 13, 1930, by W. E. Davis, E. J. Davis, H. K. English and J. E. Johnson (Record Vol. 5, pp. 1639-1640; Vol. 6, pp. 1755-1757). The claim that the Blue Grass Mining Company financed the companies is absolutely without a semblance of support. The owners of the stock in those corporations (except Mr. Johnson) are not parties to the appeal to the Circuit Court of Appeals or here.

After the contract of February 18, 1931, was made, and beginning on February 19, 1931, there were mutual accounts between the companies (Record Vol. 4, p. 1275). There never was any payment to Jeda Coal Co. It held title to the property acquired from Mr. Hull and leased to the Black Gold, which was an operating company.

The Black Gold and Blue Grass rendered mutual assistance in matters of marketing and in operating details. Sometimes the balance was in favor of Black Gold (Vol. 4, p. 1275). The contract of February 18, 1930, provided for a small stock interest in Black Gold and Jeda to be held by the corporation to be organized under the contract. When the balance was in favor of Blue Grass, interest was paid to it (Vol. 4, p. 1275).

The complainants were granted a great deal more than was fair or just or due them. The salaries and expenses were paid or credited each year and no complaint was made. Complainants were fully advised and had an agent on the ground at all times (Record, Vol. 2, pages 319-320). The properties and interests in property acquired from time to time were held according to the contract to be placed in the title-holding corporation when it should be organized, as expressly provided in the contract of February 18, 1931. The District Court revised the record of seven years and required respondents to pay back to the

corporation, Blue Grass Mining Co., large sums of money (Record, Vol. 1, p. 430). The District Judge said (Vol. 1, p. 377):

> "During a period when many other enterprises of the same character sustained heavy losses, or failed completely, the corporations here involved appear to have grown and prospered to an extent which seems really phenomenal. Obviously, this extraordinary development was due, in a large measure, to the experience, diligence and prudent supervision of J. E. Johnson, Sr. Efficient services rendered by the other members of the Kentucky group materially contributed to the successful achievement. The services so rendered extended far beyond those of a routine or perfunctory nature ordinarily expected of officers serving without pay. The Tennessee group acquiesced in the rendering of these services and as stockholders share in the benefits derived from them. These facts are amply sufficient to repel any presumption that they were to be rendered gratuitously. Fitzgerald Construction Co. v. Fitzgerald, 137 U. S. 98; Vaught v. Charleston National Bank, 62 F. (2d) 817; Paine v. Kentucky Refining Company, 159 Ky. 270, 167 S. W. 375."

Hence the Court allowed the respondents what he regarded as reasonable salaries for the years prior to March 1, 1937, but denied all compensation for 1937, 1938, 1939 and 1940, and required repayment of all in excess of what he allowed.

Without a dollar of investment, and in direct opposition to the written contract, the Court gave complainants a one-half interest in the two corporations, caused to be conveyed to the corporations all of the properties acquired and compelled Johnson and Pendleton to pay back to the corporation many thousands of dollars which they had earned and collected over the operating years with the assent and acquiescence of the complainants, and much of which had been paid to third parties for services to the

corporation. Instead of being aggrieved by the decree, the complainants have been unjustly enriched by it.

The men whose enterprise and ability originated and created the values have been penalized to enrich the complainants, who never had a dollar invested. The only money they ever put up was to be returned to them in full, under the contract of February 18, 1931, and in fact most of it had been returned to them before the suit was filed.

Instead of inadequate relief, the complainants have been given, contrary to their contract, a great and valuable interest and now seek in this Court to obtain still more of the earnings and savings of the respondents.

It is unfortunate that this Court cannot reverse the decree against the respondents and restore to them their rights and properties; but when the petition herein was filed it was too late for respondents to take a cross appeal.

The assumption that respondents were wrongdoers and had not kept their contract is absolutely unsupported by the record.

III.

RESPONSE TO BRIEF IN SUPPORT OF PETITION.

The brief for petitioners argues at great length that a trustee who had been guilty of a willful and fraudulent breach of trust, and tried to appropriate the trust estate, should be denied all compensation.

The answer to the abstract principle thus advanced is that no such case was presented by the record. There was no trustee, no breach of duty, and no attempt to take the estate.

The relationship here was purely contractual from the beginning to the end. The first contract of December 7, 1929, was the first step. The subject matter of that contract was the "bid" which Mr. Johnson controlled.

A "bid" is a property right and a proper subject matter for a contract.

Hughes v. Swope, 88 Ky. 254, 1 S. W. 394;
Johnson v. Baker, 246 Ky. 603, 55 S. W. (2d) 404.

That contract was conditioned on affirmance of the bid by the Court of Appeals. The reversal by the higher court extinguished the bid, destroyed the subject matter of the contract and ended the contractual relation.

13 C. J., Section 718, p. 643;
Juett v. C. N. O. & T. P. Ry. Co., 245 Ky. 379, 53 S. W. (2d) 551;
Aronson v. Gibbs Inman Co., 283 Ky. 107, 140 S. W. (2d) 806;
Texas Co. v. Hogarth Shipping Co., 256 U. S. 619, 65 L. Ed. 1123.

The parties recognized this and, when Mr. Johnson again bid in the property at later sales, they made the new contract of February 18, 1931. This contract then constituted the sole source of the rights of the parties to the contract.

The Eliza Lines, 199 U. S. 119, 59 L. Ed. 115.

This contract of February 18, 1931, was the only contract among the parties from that date forward. The corporations had been created under the first contract and no change was made in the organization of them and none was requested. Mr. Johnson and Mr. Pendleton operated them successfully. The petitioners had an agent on the ground at all times and assented to the management and to all the acts done, including the annual payment of salaries. The long delay was caused by litigation and circumstances beyond the control of either party. Until they could get a clear title to the property, the petitioners did not want to invest any mony or be responsible in any way.

They deliberately kept quiet and awaited the outcome of Johnson's efforts (Rec. Vol. 2, p. 362; Vol. 3, p. 484).

Such election is final and irrevocable and precludes petitioners from attacking the contract of February 18, 1931.

MacKenzie v. Eschmann's Exrs., 174 Ky. 450, 192 S. W. 521;
Farmers Trust Co. v. Threlkeld's Admr., 257 Ky. 211, 77 S. W. (2d) 616;
Grymes v. Sanders, 93 U. S. 55, 23 L. Ed. 798;
McLean v. Clapp, 141 U. S. 429, 35 L. Ed. 804;
Hoyt v. Latham, 143 U. S. 553, 35 L. Ed. 259;
Shappiro v. Goldberg, 192 U. S. 553, 48 L. Ed. 419.

The bill itself was fatally defective in failing to allege that the alleged fraud occurred within five years, or that it was not discovered within that period, and could not have been discovered by ordinary diligence.

Ky. Stats. 2515;
Wood v. James, 87 Ky. 511;
Brown v. Brown, 91 Ky. 639;
Cox v. Simmerman, 243 Ky. 474, 48 S. W. (2d) 1078.

These principles were ignored by the District Court and not even mentioned in the opinion filed.

With the contract of February 18, 1931, in force, the petitioners had no cause of action. They did not allege any breach of it by respondents, or any readiness or ability or willingness on their part to abide by it. That contract by its recitals and mutual covenants superseded all prior agreements, arrangements and negotiations and became the supreme source of the rights of the parties.

"There are two sorts of what has been termed estoppel by contract, viz., (1) estoppel to deny the truth of facts agreed upon and settled by force of entering into the con-

tract, and (2) estoppel arising from acts done under or in performance of the contract."

George v. Ford, 183 Ky. 813, 211 S. W. 438;
21 C. J., Sections 110-115, pp. 1110, 1113.

Moreover, when that contract was set aside, the petitioners had no contract at all with reference to the existing subject matter.

The prior contract relating to a previous bid could not be revived or applied to another and later bid on different terms.

A meeting was called for February 8, 1936, to be held at Lexington for the purpose of completing arrangements under the existing contract of February 18, 1931. The petitioners then for the first time questioned the contract, and made only the one question that they should have a half interest instead of the 30 per cent interest specified in the contract. This was not conceded and they refused to go into the meeting or to recognize the contract. This was a renunciation and breach of the contract and ended their rights under it.

Louisville Packing Co. v. Crain, 141 Ky. 379, 132 S. W. 575;
Roehm v. Horst, 178 U. S. 1, 44 L. Ed. 953;
Roller v. Leonard Co., 229 Fed. 615;
Fidelity & Deposit Co. v. Brown, 230 Ky. 534, 20 S. W. (2d) 284.

After this act by the petitioners they were not entitled to relief in any form or to any extent.

The District Judge said they were justified in the repudiation of the contract because (a) the Kentucky group had paid up and taken all the stock in the corporations; (b) had depleted the coal properties by five years operation; (c) and had made false representations respecting

English (Opinion, Record, Vol. 1, p. 365). The act in regard to the stock occurred in 1930, and prior to the making of the contract of February 18, 1931. It was assented to by petitioners, and by the terms of the last contract they were to purchase 30 per cent of the identical stock. The depletion of the mining property had nothing to do with the contractual relations of the parties. Not a word on that subject appears in pleading or proof, and it was not the reason given by complainants for repudiating the contract. It was a purely gratuitous assumption without any basis in fact or reason. It was never thought of by complainants. The final ground that misrepresentations were made respecting English was contrary to the previous ruling of the trial judge himself (Vol. 2, pp. 362-367).

It disregarded the rule that rescission cannot be made where the status quo cannot be restored.

> Pratt v. Carroll, 8 Cranch 471, 3 L. Ed. 627;
> Kauffman v. Raeder, 108 Fed. 171, 54 L. R. A. 247;
> Morris v. McDonald, 196 Ky. 716, 245 S. W. 903.

It disregarded the rule that action must be taken promptly upon discovery of the alleged fraud, and that an election to hold to the contract is irrevocable.

> Andrus v. St. Louis Smelting Co., 130 U. S. 649, 32 L. Ed. 1054;
> Head v. Oglesby, 175 Ky. 613, 194 S. W. 793.

After setting aside the contract of February 18, 1931, the complainants had no contract at all. But the Court gave them half of the stock in the Blue Grass Mining Company and Pendleton Store. This was in direct violation of the Constitution of Kentucky, Section 193, which reads:

> "No corporation shall issue stocks or bonds except for an equivalent in money paid or labor done, or property actually received and applied to the purposes for which such corporation was created, and neither

labor nor property shall be received in payment of stocks or bonds at a greater value than the market price at the time such labor was done or property delivered and all fictitious increase of stock or indebtedness shall be void."

The statute, section 568, is in the same language. The District Court used the dividends declared as late as December, 1936, and the $3,900.00 mentioned in the contract, which had been largely returned (Record, Vol. 1, p. 412). This was contrary to law, and very unjust to respondent, who had paid for all the stock in 1930, and had held it intact and obligated themselves to sell it to complainants in accordance with the terms of the contract of February 18, 1931.

Altenberg v. Grant, 85 Fed. 345;
Taylor v. Citizens Oil Co., 182 Ky. 350, 206 S. W. 644.

It is a fundamental law of contracts, applicable to contracts respecting stock in a corporation, that the contract of the parties will be enforced as made, provided it offends no rule of law, and a subscriber to stock is not bound to take stock except upon the terms and conditions of his subscription.

14 C. J., Sec. 832, page 536;
Putnam v. New Albany & S. C. J. R. Co., 16 Wall. 390, 21 L. Ed. 361.

It was not alleged nor proven that the plaintiffs ever paid or ever offered to pay for any stock in either of said corporations. The allegations that plaintiffs were entitled to certain stock is a legal conclusion, which is not only ineffective for any purpose, but is contradicted by the other facts alleged.

The corporation or its creditors might have enforced a subscription which had not been paid, but the parties to

the contract of December 7, 1929, could not do so except in accordance with the conditions of the agreement.

In 11 Encyclopedia of U. S. S. Court Reports, p. 205, the Supreme Court is quoted as follows:

> "Without express regulation to the contrary, a person becomes a stockholder (a) by subscribing for stock, (b) paying the amount of the subscription to the company or its proper officer, and (c) being entered on the books as a stockholder."
>
> Pacific Nat. Bank v. Eaton, 141 U. S. 227, 35 L. Ed. 702;
> Howley v. Upton, 102 U. S. 314, 26 L. Ed. 179;
> Potts v. Wallace, 146 U. S. 689, 36 L. Ed. 1135;
> Upton v. Tribilcock, 91 U. S. 45, 23 L. Ed. 203.

A contract fixing terms upon which stock may be obtained by performance of such terms does not constitute the contracting party a stockholder. The contract of February 18, 1931, foreclosed all that had gone before, and governed all that came after it. When complainants renounced and repudiated that contract, they cut off all right they had under it. Without performance of the conditions, a contract or option or right to purchase or to acquire stock in a corporation confers no beneficial interest in, lien upon, or title to, the stock.

Richardson v. Hardwick, 106 U. S. 255, 27 L. Ed. 145;
Life Preserver Suit Co. v. National L. P. Co., 252 Fed. 139;
Boyd County Fair Ass'n v. Eastham, 208 Ky. 368, 270 S. W. 12;
Bourne v. Miller, 4 Fed. (2d) 1007;
Greene v. Signa Iron Co., 88 Fed. 203;
Matheson v. Hicks, 10 Fed. (2d) 883;
French v. Hay, 89 U. S. 238, 22 L. Ed. 799.

The charge that Mr. Johnson and Mr. Pendleton sought to obtain personal profits at the expense of the corporation is repeated over and over in the argument, but it is without any basis in truth. The properties acquired and held in their names were for the benefit of the corporation to be organized, and it was never the plan or intention to put titles in the operating company. All these transactions were entered on the books and records, and it was expected that the contract of February 18, 1931, would be carried out and all assets would be vested in the new corporation as expressly agreed. Complainants assented to it at the time, and understood how and why it was done that way. Until the time for transfer arrived, the properties had to be held in some convenient form. The salaries set up or paid from year to year were based on the results of operations each year. It was proven without contradiction that they were reasonable and within the average of similar expenditures in the area involved (W. S. Denham, Vol. 6, p. 1771; R. H. Kelly, Vol. 5, pp. 1600-1622; W. W. Miller, Vol. 6, pp. 1623-1633; Turner Howard, Vol. 6, pp. 1843-1851; E. C. Perkins, Vol. 6, pp. 1827-1840.

Moreover, the assent and acquiescence of the complainants over the period including 1930, 1931, 1932, 1933, 1934, 1935 and 1936, in the amount of salaries allowed, was a complete bar to any later complaint by them.

IV.

JURISDICTION OF DISTRICT COURT.

The jurisdiction of the United States District Court is limited to controversies wholly between citizens of different states, when the cause of action does not arise under the Constitution or laws of the United States. The formal position of the parties is not decisive. The parties, to determine jurisdiction of the court, will be aligned accord-

ing to interest. The real, rather than the formal, party is regarded.

Stewart v. B. & O. Ry. Co., 168 U. S. 445, 42 L. Ed. 537;
Niles-Bement Pond Co. v. Iron Moulders Union, 254 U. S. 77, 65 L. Ed. 145;
Steele v. Culver, 211 U. S. 29, 53 L. Ed. 74.

Where diversity of citizenship is the sole ground of jurisdiction, parties will be aligned in accordance with their real interest in the controversy, to determine whether there is such diversity, and if no diversity exists the action will be dismissed.

(6 C. C. A.) Berg v. Merchant, 15 Fed. (2d) 990.

The essential question is whether the complainant is seeking to enforce, in whole or in part, a right of the defendant sought to be realigned as a complainant; and, if so, whether such defendant is an indispensable party so as of necessity to destroy the "diversity of citizenship."

(6 C. C. A.) Detroit T. & M. Co. v. Mason Contractors Assn., 48 Fed. (2d) 731.

The sole purpose of the accounting feature of the suit is to require the individual defendants to pay back money paid to them by the corporations for services, expenses, etc. It is a claim on behalf of the corporations alone, and they alone would be directely interested in the recovery. The incidental interest of a potential stockholder in the ultimate result is not regarded.

The interests of the corporation and the interests of Johnson and Pendleton are alleged by the bill to be antagonistic (Bill of Complaint, Vol. 1, p. 4).

That is obviously true. Hence the accounting sought is essentially a claim on behalf of the corporations against the individual defendants, all citizens of Kentucky.

In Geneva Cooperage Co. v. Karpen & Bros., 238 U. S. 254, 59 L. Ed. 1295, it was held:

> "The jurisdiction of the federal courts as limited and fixed by Congress cannot be enlarged by uniting in a single suit, under the rule governing the joinder of causes of action in suits in equity, causes of action of which the court is without jurisdiction with one of which it has jurisdiction."

In Blacklok et al. v. Small et al., 127 U. S. 96, 32 L. Ed. 70, it was held:

> "The Circuit Court of the United States has no jurisdiction of a suit which is substantially by and for the benefit of one of the defendants, named therein, who was at the time of the commencement of the suit, and has since continued to be, a citizen of the same state with another defendant therein, against whom the substantial relief in the action is claimed."

In Mass v. Furlong (6 C. C. A.), 93 Fed. (2d) 182, it is said:

> "Jurisdiction cannot be enlarged by uniting in one suit a cause of action over which we assume that the District Court has jurisdiction with another over which it had not." Citing:
>
> Geneva Fur Co. v. Karpen & Bros., 238 U. S. 254, 59 L. Ed. 1295.

See, also:

Goss v. Henry McCleary Timber Co., 82 Fed. (2d) 477;

Lockett v. Delpark, Inc., 270 U. S. 495, 70 L. Ed. 703.

In Hurn v. Oursler, 298 U. S. 238, 77 L. Ed. 1148, it was said:

> "But the rule does not go so far as to permit a federal court to assume jurisdiction of a separate and

distinct nonfederal cause of action because it is joined in the same complaint with a federal cause of action."

What the plaintiffs ask is that the Johnsons and Pendleton, citizens of Kentucky, be required to pay to the Kentucky corporation certain sums of money claimed to have been improperly collected from the corporations over a period of several years. That is a controversy between citizens of Kentucky alone; and the plaintiffs could not, in any event, collect or claim any money that might be held to be due the corporations. The interests of the corporations and of the individuals are adverse and antagonistic, and they must necessarily be aligned in opposition. Clearly, in such a situation, the diversity of citizenship essential to jurisdiction is destroyed.

In the case of Hawes v. Contra Costa Water Co., 104 U. S. 450, 26 L. Ed. 827, a bill was held bad for want of equity because the plaintiffs had not exhausted their opportunity for self-help within the corporation. That case gave the subject profound consideration and out of it grew Equity Rule 94, which was the same as the present Rule 27, with the addition of the words at the end, "or the reasons for not making such effort."

The present bill does not allege any facts to excuse the holders of one-half the stock of a corporation from making an effort to get relief from the directors or stockholders. The proof shows that they refused to enter a meeting of the parties interested, or to discuss any business until their contract was changed.

It will be noted that the allegations of the bill (Vol. 1, pp. 3-5) are almost precisely the same as appeared in the Venner case, which were held inadequate in a suit by a minority stockholder. Turning to that case we find:

In Venner v. Great Northern Ry. Company and James J. Hill, 209 U. S. 24, 52 L. Ed. 666, a suit was filed by

Venner, a minority stockholder, against the corporation and Hill, to compel Hill, who was a director and president of the corporation, to account to the corporation for an alleged profit made by him on stock sold to the company. The lower court aligned the corporation with the plaintiff and dismissed for want of jurisdiction, both the corporation and Hill being residents of Minnesota.

The Court recognized the rule that the arrangement of the parties should be made so as to align them according to their interest and attitude to the controversy, and then to determine the question of jurisdiction in view of the realignment. The Court said:

> "It would doubtless be for the financial interest of the defendant railroad that the plaintiff should prevail. But that is not enough. Both defendants unite, as sufficiently appears by the petition and other proceedings, in 'resisting the plaintiff's claim of illegality and fraud.' They are alleged to have engaged in the same illegal and fraudulent conduct, and the injury is alleged to have been accomplished by their joint action. The plaintiff's controversy is with both, and both are rightfully and necessarily made defendants, and neither can, for jurisdictional purposes, be regarded otherwise than as a defendant. Davenport v. Dows, 18 Wall. 626, 21 L. Ed. 938; Central R. Co. v. Mills, 113 U. S. 249, 28 L. Ed. 949, 5 Sup. Ct. Rep. 456; East Tennessee V. & G. R. Co. v. Grayson, 119 U. S. 240, 30 L. Ed. 382, 7 Sup. Ct. Rep. 190; Doctor v. Harrington, 196 U. S. 579, 49 L. Ed. 606, 25 Sup. Ct. Rep. 355; Groel v. United Electric Co., 132 Fed. 252; and see Chicago v. Mills, supra."

The distinction is in this fact:

A minority stockholder would be wholly defeated where the corporation refused to repudiate the purchase, and, the corporation itself being a wrongdoer in the matter, it could not be aligned on the other side. In this case the

plaintiffs claim to own one-half of the stock of the corporation, and do not charge or claim that the corporation itself did any wrong or engaged in any conduct that is made the basis of the claim against the individuals, or that holders of half the stock could not get relief, if they asserted themselves.

The same distinction was presented in the Harrington case, which was followed.

But the case of Venner v. G. N. Ry. Co. went further and affirmed the judgment of dismissal on another ground. Venner had not shown by proper averments:

(1) That he was a stockholder when the assailed transaction took place; and

(2) That he had made any effort to comply with Equity Rule 24 by setting forth with particularity the efforts he had made to secure action by the management, or, if otherwise, the causes of his failure to obtain such action.

He did allege that Hill had absolute control of the whole board of directors, and stated about the same conclusions stated in the bill in this case.

According to the rule of Hawes v. Contra Costa Water Co., 104 U. S. 450, 26 L. Ed. 827, and the cases, supra, the bill is bad for want of equity.

Equity Rule 27 has now been superseded by Rule 23 (b), which is as follows:

> "Rule 23 (b). In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complainant shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains of law, and (2) that the action is not a collusive one to confer on a court of the

United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complainant shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees, and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action, or the reasons for not making such effort."

In Hamer v. New York Rys. Co., 244 U. S. 266, 61 L. Ed. 1125, the suit was dismissed for lack of jurisdiction after aligning a trust company with the plaintiffs. The distinctions in the cases are clearly noted. Says the Court:

"It is not contended that this refusal to sue makes the Trust Company an adversary, to be classed for purpose of jurisdiction with the real defendants—as in those cases where the refusal to sue was part of a fraudulent participation in the wrongdoing, and where the trustee or corporation in effect ranged itself in opposition to the relief sought."

Venner v. Great Northern Ry. Co., 209 U. S. 24, 52 L. Ed. 666;
Doctor v. Harrington, 196 U. S. 579, 49 L. Ed. 606;
Kelly v. Miss. R. C. Co., 175 Fed. 492;
Groel v. United Elect. Co., 132 Fed. 252.

"The Trust Company having, as we have shown, a real interest in the controversy, which makes it a necessary party to the suit, must be aligned as a party plaintiff where its interest lies."

Blacklok v. Small, 127 U. S. 96, 32 L. Ed. 70;
Harter Tp. v. Kernochan, 103 U. S. 562, 26 L. Ed. 411;
Pacific R. Co. v. Ketchum, 101 U. S. 289, 25 L. Ed. 932;
Allen-West Com. Co. v. Brashear, 176 Fed. 119;
Shipp v. Williams, 62 Fed. 4.

On the face of the bill it is very clear that no facts are alleged to bring the case within the jurisdiction of the

Court. On the facts of the record, there is a failure to prove that the plaintiffs are stockholders in any of the corporations. As a matter of fact, they were not at any time stockholders. The only rights they had were defined by the executory contract of February 18, 1931, under which they could have become stockholders by conforming to its terms. But when they renounced that contract, they were left without any cause of action of any kind, or for any purpose, and without a right to acquire stock, or to obtain relief at law or in equity.

V.

BLACK GOLD MINING COMPANY STOCK.

The petitioners argue that the refusal of the lower courts to confiscate the stock of W. E. Davis, E. J. Davis and J. E. Johnson, Sr., in Black Gold Mining Company was probably contrary to decisions of this Court. There is no decision of this or any other court in this country that petitioners have or ought to have any claim to the stock of Black Gold Mining Company.

The Black Gold was not financed in any way by the Blue Grass. Months after it was in operation, and after the contract of February 18, 1931, was made, the companies had some mutual charges and credits growing out of operations for the convenience of the parties. The accounts were never large and, when the balance was in favor of Blue Grass, legal interest was paid (Record, Vol. 4, p. 1275, Lavender). When Mr. Garth and Mr. Pendleton did work for Black Gold, they were paid by Black Gold (Vol. 5, p. 1711). The claim of petitioners to the stock of Black Gold and Jeda is utterly unsupported by any fact and neither E. J. Davis nor W. E. Davis are parties, although they own all the stock except that held by Mr. Johnson. The claim is purely fictitious, and the whole argument irrelevant for lack of factual support.

The petitioners have been unjustly enriched at the expense of respondents and, having been so successful in that demand, they look with covetous eyes upon the Black Gold Mining Company and Jeda Coal Company and seek to appropriate their properties.

Wherefore, it is respectfully submitted, the petition for a writ of certiorari should be denied.

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Ashland, Kentucky,
July 6, 1942.